Inquiry into Australia's Future Tax System – Henry Report

TAXATION REVIEW

Submission from

Geoff Dunsford
Darren Wickham

On

TAXATION REFORM

Contents **Page**

Authors

We are two actuaries whose main work and interest are in the field of superannuation and retirement incomes.

October 2008

Introduction

The main focus of this submission is the complexity of the tax system in relation to individuals and superannuation. We offer a number of suggestions on simplification.

We note also that the superannuation tax system is highly inequitable. Members on higher incomes are disproportionately advantaged, while many on low incomes actually suffer tax where none would apply under alternative investment. Our proposals eliminate this inequity.

The recently established First Homebuyers Savings Account provides for savings on a similar tax basis to superannuation. We suggest possible ways in which the FHSA and superannuation accounts may be integrated to benefit savers and reduce administration costs.

We also provide some thoughts on tax policy generally.

Summary of Recommendations

Personal Income Tax Scale

Restructure tax scale to accommodate:

- Removal of Low Income Tax Offset, Mature Age Workers Tax Offset, Senior Australians Tax Offset, Pensioner – Non Seniors Tax Offset, and
- Exemption of Age Pension from Income Tax

Tax on Capital Gains

- Remove discount on taxation of all capital gains for the purposes of taxation of personal income, trusts and superannuation funds.
- Apply “averaging” of the marginal tax rate for personal income tax assessment over the period the asset has been held.

Introduce Equitable Superannuation Tax System

- <u>No</u> personal tax relief for contributions; employer contributions treated as taxable income; (effectively all contributions become “undeducted”);
- <u>No</u> tax on contributions and investment income received in the superannuation fund;
- <u>No</u> tax on benefits paid, whether as a result of withdrawal after Preservation age or death or disablement at any time;
- Government co-contributions for lower earners

First Home Saver Accounts – Make available under Superannuation Choice of Fund

- Allow First Home Saver Accounts (FHSA) to be a valid <u>alternative</u> under Superannuation Choice of Fund.
- Once the FHSA has been closed (to release funds for the purchase of the first home, or transfer to superannuation), superannuation contributions for retirement would be resumed.

Detailed Argument

More detail on the above points in contained on the following pages.

▪ ▪ ▪

We would be happy to expand on our submission at your convenience.

Yours sincerely,

Geoff Dunsford
3 Lindel Place
Lindfield NSW 2070
Telephone 02 9416 6944 / 0411 297 627
gandndunsford@optushome.com.au

Darren Wickham
22 Parkview Rd
Fairlight NSW 2094
02 9977 1717 / 0408 900 095
wickhamd@bigpond.net.au

Personal Income Tax Scale

We accept that the determination of taxable income may have some complexity when applying the general principles of assessable income less expenditure incurred in deriving that income.

However, there should be no complexity in applying a suitable progressive tax scale to derive the tax payable.

It is highly desirable that the income tax scale is readily understood, so that community acceptance and support for it is widespread. It needs to be accepted generally as fair, in order to minimise attempts for evasion.

The existence of a range of different tax offsets which affect more than half of all taxpayers causes significant misunderstanding.

Fundamentally there should be no need for the Low Income Tax Offset (LITO). The tax scale can be adjusted to accommodate any desire for greater progression to favour low income earners.

Equally there should be no need for the pensioner tax offsets – for the "Senior Australian" and "Pensioner Non-senior". Pensions could be made exempt from tax – consistent with pensions paid by private superannuation funds. This action, combined with changes to accommodate elimination of LITO, can result in a new scale with acceptable outcomes for all taxpayers.

Senior Australians Tax Offset (SATO)

SATO was introduced in 2001 with a stated objective of ensuring that those eligible (essentially Age Pensioners) would pay no tax unless their annual taxable income exceeded $20,000.

The maximum tax offset of $2,230 was reduced by 12.50 cents per $1 for incomes in excess of this. Effectively, this meant that those whose taxable incomes were less than the then upper threshold of $38,707 would receive some offset. Taxable incomes in excess of this would pay tax according to the standard scales, ie, without any offset.

Since that time, the minimum and maximum "shade out" taxable income limits have been increased to $28,867 and $46,707 respectively. The percentage increase is broadly equivalent to that represented by the increase in the Age Pension over this period.

Maximum Offset Unchanged Since 2001

However, the maximum $2,230 offset has not been changed. Accordingly, for those eligible, the maximum taxable income where no tax is payable has only moved from $20,000 to$20,867.

If SATO continues in its current form, then, to reinstate the principles which applied in 2001, the maximum offset should be increased to the tax currently payable on $28,867 according to the current tax scales – ie **$3,430**.

Exempt Age Pension from Tax

However, we are proposing that Age Pension payments should be made exempt from tax – consistent with pension payments from private superannuation funds. The effect of this measure for those on the Age Pension assuming (1) current tax system including current SATO, and (2) excluding SATO, is as follows:

Tax Payable ($)

Taxable Income Age Pension (prior to 20 9 08) + Pharmaceutical Benefits Allowance +…….	*Taxable Income Total ($)*	*Currently*	*Age Pension Exempt*	*No SATO, Age Pension exempt*
Full AP + PBA	14,368	**nil**	**nil**	**nil**
Full AP + PBA + max other income for full pension (3,588)	17,956	**nil**	**nil**	**nil**
70% AP + PBA (10,103) + other income (14,251)	24,354	**523**	**nil**	**1,238**
40% AP + PBA (5,838) + other income (24,914)	30,752	**1,719**	**607**	**2,837**
10% AP + PBA (1,573) + other income ($35,576)	37,149	**3,950**	**3,282**	**4,673**

Removing SATO would clearly require part Age Pensioners to pay more tax – even if the part pension was made tax exempt.

Proposed Tax Scale – No Tax Offsets

If the zero tax band limit was increased from $6,000 to $14,000, and the 15% band upper limit reduced from $34,000 to $31,000, exempting the Age Pension from tax and removing SATO would reduce the tax in the above examples to reasonable levels.

To complete the changes to the tax scale, ie, to broadly maintain current tax payable for higher incomes, it would be necessary also to reduce the 40% tax rate threshold from $80,000 to $73,000. The threshold for the 45% tax rate would remain at $180,000.

The proposed tax scale changes would result in the following:

Current (including SATO) — *Proposed*

Taxable Income	Tax Payable	*Taxable Income*	*Tax Payable*
Up to $20,867	Nil	*Up to $14,000*	*nil*
$20,868 to $28,867	**15%** of excess over $20,867		
$28,868 to $34,000	$1,200 + **27.5%** of excess over $28,867	*$14,001 to $31,000*	***15%** of excess over $14,000*
$34,001 to $46,707	$2,612 + **42.5%** of excess over $34,000		
$46,708 to $80,000	$8,012 + **30%** of excess over $46,707	*$31,001 to $73,000*	*$2,550 + **30%** of excess over $30,000*
$80,001 to $180,000	$18,000 + **40%** of excess over $80,000	*$73,000 to $180,000*	*$15,150 + **40%** of excess over $73,000*
$180,001 +	$58,000 + **45%** of excess over $180,000	*$180,001 +*	*$57,950 + **45%** of excess over $180,000*

Adoption of the proposed tax scale without offsets would facilitate a better understanding of the tax system in the community and avoid current confusion.

Comparison of Results

A summary of the results of comparing the current tax arrangements with those under the proposed structure is as follows:

	Tax Payable - Seniors		Tax Payable – Others	
Taxable Income	Current – with Seniors/ Low Income Offset	*Proposed new scale – with Age Pension exempt*	Current – with Low Income Offset	*Proposed new scale*
$14,368	nil	*nil*	$55	*$55*
$17,956	nil	*nil*	$593	*$593*
$24,354	$523	*$38*	$1,553	*$1,553*
$30,752	$1,719	*$1,637*	$2,543	*$2,513*
$37,149	$3,950	*$3,923*	$4,231	*$4,395*
$50,000	$8,600	*$8,250*	$8,600	*$8,250*
$80,000	$18,000	*$17,950*	$18,000	*$17,950*

People currently classified as “Pensioners – Non Seniors” have a similar tax offset structure to the “Seniors”. If pensions payable to the “Non Seniors” are also made exempt from tax, the results for this group will be similar to those above for “Seniors”.

The Mature Age Worker Tax Offset (MAWTO) is lower than the Low Income Tax Offset for annual incomes up to $47,500. Then, for incomes up to $63,000 it is higher by up to $200 in the year. (Above $63,000, no Offset applies under either arrangement.) Those currently eligible for the MAWTO earning between $47,500 and $63,000 would therefore be marginally disadvantaged under the proposed new scale.

It is envisaged that implementation of any change along the lines suggested would be made at a time when other changes to the tax scale are planned, so that the number of individuals disadvantaged are kept to a minimum and any increase in tax is also kept to a minimum.

RECOMMENDATIONS

Restructure tax scale to accommodate:

- Removal of Low Income Tax Offset, Mature Age Workers Tax Offset, Senior Australians Tax Offset, Pensioner – Non Seniors Tax Offset, and

- Exemption of Age Pension from Income Tax

Tax on Capital Gains

Capital gains are clearly simply another form of investment income. There is fundamentally no justification for taxing them on a different basis from interest, dividends and rents.

Prior to 1999 they were taxed in full and at full marginal rates, after allowing for indexing of the cost price in line with CPI.

The 1999 Ralph review put the following arguments in favour of *cutting* capital gains tax:

- It would encourage a greater level of investment, particularly in innovative, high growth companies (particularly Venture Capital);
- It would substantially improve the operation of Australian capital markets;
- It would help support a stronger investment culture amongst ordinary Australians;
- Other countries have more favourable tax regimes and competition for capital will become more intense. Failure to attract investment funds will mean lower levels of economic growth;
- A (then) recent Financial Review article argued that taxes on capital were "productivity sapping"

On the other hand, many economists consider that treating capital gains differently from other income has distorting effects (as well as inviting creation of avoidance mechanisms).

The following observations can be made:

- There is little evidence that there has been a substantially higher level of venture capital and growth investments following the introduction of the CGT discount in September 1999. The question has to be asked: has the Government received "bang" for its tax expenditure "buck"? Could the cumulative $35 billion in tax expenditures since 1999 have been better spent elsewhere?
- The improvement in operation of capital markets is difficult to prove or disprove;
- Superannuation funds have not changed their investment behaviour following the introduction of the tax discount;
- The main beneficiaries of reduced capital gains tax are wealthy individuals;
- The discount played a destructive role in the development of a housing "bubble" in the years up to 2003 (through the CGT discount applying to investment properties).

If the discount is withdrawn, it might be argued that we should return to indexing the cost price in determining the tax payable.

We reject this argument as no indexing applies in the case of the taxation of other investment income.

It is proposed therefore that all capital gains be taxed in full, without any indexing of the cost price. This should apply to the taxation of gains for personal income tax purposes, and also the taxation of trusts and superannuation funds.

It would be reasonable however, to allow for "averaging" of the marginal tax rate for personal income tax assessment to be applied following sale, over the period the asset has been held. The operation of this process is set out in the following example:

Purchase		Capital Expenditure		Sale	
Date	Price	Date	Spent	Date	Proceeds
12/99	$220,000	2/04	$30,000	9/08	$460,000

Net Gain is (460,000 – 220,000 – 30,000) = $210,000.

Period between Purchase and Sale is 8 and three quarter years.

Average annual gain = $210,000/8.75 = **$24,000.**

Assume other taxable income is $55,000. Taxable income including average annual gain is $55,000 + $24,000 = $79,000.

Tax on $55,000 is $10,500; tax on $79,000 is $17,700; **tax on average annual gain** of $24,000 is 17,700 – 10,500 = **$7,200.**

Hence tax on whole gain of $210,000, is 7,200 x 8.75 = $63,000.

(This contrasts with the tax that would have been levied if the whole of the gain had been assessed in the year of sale, ie, $85,750).

Effectively the gain is being taxed as equivalent to interest earned each year over the period (albeit using the tax scale in force at the end). The taxpayer receives the benefit of deferment since the enjoyment of the gain is also deferred.

RECOMMENDATIONS

- Remove discount on taxation of all capital gains for the purposes of taxation of personal income, trusts and superannuation funds.
- Apply "averaging" of the marginal tax rate for personal income tax assessment over the period the asset has been held.

An Equitable Superannuation Tax System

Summary

Main Features:

A comparison of the main features of the suggested system with the current system is as follows:

Current System

- tax relief for deductible contributions paid by self employed; employer contributions (including salary sacrifice) not taxed in the hands of the employee – so that the employee effectively receives tax relief on them;

- 15% tax on contributions and investment income received in superannuation fund (10% on capital gains realised after more than 12 months);

- no tax on pension and withdrawal benefits paid after age 60; (prior to age 60, tax applies at various concessional rates on benefits paid in excess of a tax free threshold, currently $145,000);

- no tax on death benefits paid to a dependent; (tax payable on death benefits in other circumstances and on disability income benefits);

- Government co-contributions for lower earners.

Equitable System

- **No** personal tax relief for contributions; employer contributions treated as taxable income - effectively all contributions become "undeducted";

- **No** tax on contributions and investment income received in the superannuation fund;

- **No** tax on benefits paid, whether as a pension or as the result of withdrawal after Preservation age or death or disablement at any time;

- Government co-contributions for lower earners.

Equitable System

The system presented above recognises that super contributions paid by an employer, whether or not on a salary sacrifice basis, could reasonably be considered as part of the employee's remuneration. Hence, without the current tax rules, the contributions would be part of taxable income.

Contributions invested on this basis would then carry no tax advantage. Investment of those contributions in a tax free fund would provide an equitable tax incentive – ie, the investment returns would be proportionate to the contributions invested.

With benefits tax free, again equitable outcomes are achieved.

Increased Benefits for Most Members

On reasonable assumptions, over a working lifetime of 40 years, financial outcomes under the Equitable system for workers on incomes up to $80,000 pa, the outcomes are higher than those under the current system.

Thus around 90% of all workers would have increased benefits on this basis.

Adequacy Improved

By eliminating the tax on contributions, the Equitable system enables

(a) the 9% Superannuation Guarantee contributions, and

(b) contributions from members and the government under the co-contribution scheme,

to generate higher benefits for all members than under the current system.

This assists the general aim of improving the adequacy of retirement benefits.

Impact on Members' Personal Tax

While the removal of fund taxes will ultimately provide satisfactory financial outcomes, the immediate impact of introducing the Equitable system will be the withdrawal of tax concessions on (deductible) contributions – leading to an increase in personal tax payable.

It is estimated that the suggested additional measures will increase the Budget surplus by around $8.0b pa, and growing. This could be used to adjust the personal income tax scale to offset or ameliorate the personal tax increases.

Advantages of Equitable System

- Provides a "level playing field" for members with different taxable incomes – the tax benefits are proportionate to the contributions invested;

- Investment in a tax free fund provides significant tax incentive to encourage voluntary contributions;

- Provides simplicity for superannuation funds - no taxes on contributions, investment income, capital gains; no provisions for unrealised gains and no complex unit price adjustments;

- Provides further simplicity for members – no two tiered system of contributions; more comprehensible system generally – which should generate increased enthusiasm and support for the superannuation system;

- Avoids need for transitional measures: the removal of personal tax relief and contributions tax can take place simultaneously from the beginning of a particular tax year, putting all members in the same position;

- Avoids need for special provisions for spouse contributions or income splitting;

- Avoids concern with potential recontribution strategies abusing the system;
- Improves adequacy under the Superannuation Guarantee arrangements without increasing the 9% contribution rate;
- Generates higher benefits from the same contributions under the Government's co-contributions scheme;
- Avoids need to test for dependency when paying death benefits;
- Avoids potential for abuse from excessive deductible contributions by higher rate taxpayers;
- Reduces need for further changes to the superannuation tax system.

Current System

The inequity in the current system arises mainly as a result of the different rates of personal tax relief effectively available on (deductible) contributions.

Subject to quite high limits, contributions paid by employers are not taxable in the hands of employees; this facilitates employees sacrificing part of their salary in order to increase their contributions through their employers. Effectively, employer contributions are paid out of pre tax income and are equivalent to obtaining personal tax relief on those contributions. Self employed members are able to obtain tax deductions for contributions paid directly (subject to some restrictions).

After allowing for the 15% contributions tax, the net tax concessions for those on different levels of taxable income are as follows:

Taxable Income ($)	9% Contribution ($)	Personal Tax Relief (%)	Contributions Tax (%)	Current Net Tax Concession (%)	Current Net Tax Concession ($)
20,000	1,800	16.5	15	**1.5**	**27**
60,000	5,400	31.5	15	**16.5**	**891**
100,000	9,000	41.5	15	**26.5**	**2,385**
200,000	18,000	46.5	15	**31.5**	**5,670**

This position could be justified if benefits payable from superannuation funds were taxed at the same marginal rates, ie they were treated as deferred income. In practice, retirees pay no tax on benefits paid after age 60.

This structure is highly regressive, and significantly inequitable.

All members enjoy the additional benefits of the application of the concessional tax rate of 15% tax on investment earnings (10% on capital gains) during the accumulation period, and zero tax when the fund is supporting pension payments. This exacerbates the inequity in the financial outcomes.

Move to Equitable System

It is suggested that the current superannuation tax system is simplified as follows:

(1) Remove the personal tax relief applying to contributions by self employed members, and that effectively applying to employees in respect of employer contributions; employer contributions would be included in taxable income.

(2) Remove the contributions and investment income tax on superannuation funds.

(3) Remove tax on benefits whenever taken.

These relatively straightforward measures would have the effect of producing a superannuation tax system where there would be:

No personal tax relief for contributions; and employer contributions would be treated as taxable income - effectively all contributions become “undeducted”;

No tax on contributions and investment income received in the superannuation fund;

No tax on benefits paid.

Apart from the clear simplification, the tax concessions would become equitable as between members with different taxable incomes. The tax concessions would comprise simply the application of a zero tax rate on investment earnings (with imputation credits paid), so that the tax benefit would always be proportionate to the amounts invested.

The tax free investment environment, together with the Government’s co-contribution scheme for lower earners, would provide appropriate incentive for all individuals to save for retirement.

Impact on Members

Comparison Process

The projected benefits under the Equitable System would **automatically be larger** than under the current system for the same contributions. This is because no tax would be deducted from either the contributions or the investment returns.

This increase in projected benefits under the Equitable System is a result of the shift of the tax burden out of the superannuation system and on to the individual. It may be argued that this represents a forced increase in saving since disposable income is reduced by the increased PAYG incurred, but the resulting net amount going into superannuation will be larger.

Therefore, to ensure a fair comparison between the current system and the Equitable System, we have adjusted for this amount of "forced saving". A reasonable way to do this is to adjust the contribution under the current system by "grossing up" by the member's effective tax relief, at his or her marginal tax rate. This is equivalent to "salary sacrificing" the difference, and has the effect of putting the member in the same "net cost of contribution" position under both systems.

For example: assuming salary $60,000, 9% contribution of $5,400 grossed up at 31.5%, ie, $5,400/(1-.315) = $7,883

	Current System	Current System + Salary Sacrifice	*Equitable System*
Annual Salary	$60,000	$60,000	*$60,000*
9% Superannuation	$5,400	$5,400	*$5,400*
Salary Sacrifice	-	$2,483	-
Total Super Contributions	**$5,400**	**$7,883**	***$5,400***
Less Effective Tax Relief on Total Super Contribution	($1,701)	($2,483)	*nil*
Net Cost of Super Contributions to Member	**$3,699**	**$5,400**	***$5,400***

Assumptions

The following comparisons assume superannuation contributions of 9% of taxable income and the proposed personal tax scale for 2008/09.

Superannuation fund investment earnings after expenses, are assumed at the rate of 8% pa including 1% from imputation credits. A 4% pa inflation rate has been assumed for earnings; this has also been used to convert final benefit numbers to 2008 dollars. All tax thresholds are assumed to be indexed at 4% pa.

Benefits Comparison after 40 years

Current Taxable Income	**Marginal Tax Rate (+ Medicare levy)**	**Current System**	**Equitable System**
$20,000	16.5%	$138,000	**$171,000**
$60,000	31.5%	$505,000	**$515,000**
$100,000	41.5%	$985,000	**$858,000**
$200,000	46.5%	$1,978,000	**$1,715,000**

Overall, the numbers suggest that long term benefit outcomes under the two systems are likely to be broadly equivalent for all but the top earners.

The Equitable System provides higher benefits than those under the current system for the members illustrated with taxable incomes of $20,000 and $60,000. In practice, this applies to all those who obtain effective tax relief on contributions up to 31.5%, ie, up to incomes of $80,000 including super contributions. But it generates lower outcomes than the current system when the marginal tax rate increases to 41.5%. This is due mainly to the withdrawal of the effective tax relief on contributions under the suggested system.

Benefits Comparison after shorter periods

For example: 20 years

Current Taxable Income	Marginal Tax Rate (+ Medicare levy)	Current System	Equitable System
$20,000	16.5%	$48,000	**$55,000**
$60,000	31.5%	$176,000	**$164,000**
$100,000	41.5%	$344,000	**$294,000**
$200,000	46.5%	$693,000	**$549,000**

While arguably it is the 40 year working lifetime that is most relevant period over which to compare the systems, it is noted that the Equitable system outcomes are lower over the 20 year period for those with marginal tax rates of 31.5% and higher.

Indeed in the first year, the loss of effective tax relief on contributions would be felt keenly by members, as employees would be required to pay tax on their employer's contributions for the first time.

Government Budget Impact

Approximate calculations estimate that the impact of the suggested measures in the current year would be:

- Removing personal tax relief on employer contributions – additional revenue $17.5bn.

- Removing superannuation fund taxes – additional expenditure $9.5bn.

Thus the suggested measures would increase the Budget surplus by around $8.0bn in the first year.

The table below illustrates the projected fiscal impact of superannuation taxes (and the tax expenditure as a result of personal tax relief on employer contributions:

Year Ended 30 June	Tax Revenue as a Proportion of GDP				
	Contributions Tax	**Investment Tax**	**Total Super Tax**[1]	**Personal Tax Relief on Employer conts**[2]	**Net Budget Impact of Super**[3]
2008	0.56%	0.30%	0.86%	-1.61%	-0.75%
2025	0.53%	0.50%	1.03%	-1.54%	-0.50%
2040	0.52%	0.65%	1.17%	-1.47%	-0.30%

A conclusion that can be drawn from the table is that the most significant superannuation tax measure impacting on budget outcomes are not the superannuation taxes, but the tax expenditure as a result of personal tax relief on employer contributions. The main beneficiaries of this tax relief are high income earners.

“Spending” Additional Surplus

The additional Budget surplus could be utilised in making adjustments to the personal tax scales to provide the majority of members with some compensation for paying tax on their contributions.

One option would be to adjust the tax thresholds to ensure that all those on less than average earnings are fully compensated for the tax on the contributions.

Contribution Limits

Currently, annual contribution limits are $50,000 “deductible” plus $150,000 “undeducted”.

Under the Equitable system, where all contributions are treated similarly, ie, as undeducted, it could be argued that the logical maximum annual contribution is made equal to the sum of the current annual contribution amounts, ie $200,000.

The focus of the analysis in this submission has been on comparing financial outcomes under the proposed system with those under the current system from making “deductible” contributions. We have noted that broadly equivalent benefits are achieved over a working lifetime under both the current system and the suggested system.

[1] Total Super Tax (including Contributions Tax, Investment Tax and Benefits Tax) based on Institute of Actuaries of Australia paper “Tax-free superannuation benefits: a future revenue problem?”(2006) updated by Darren Wickham
[2] Estimates by Darren Wickham
[3] Excludes tax expenditure on concessional investment tax

Undeducted contributions under the current system are invested in a fund on the basis that the investment income is taxed at 15% (capital gains realised after more than 12 months taxed at 10%) during the accumulation period.

Under the suggested system, this tax is reduced to zero. This would provide a significant extra benefit for undeducted contributions over time.

Consequently, if the suggested system is implemented, the Government may wish to review contribution limits.

Transitional arrangements?

We suggest that the additional measures to implement the Equitable System (and the personal income tax scale).could be introduced without the need for any transitional arrangements (other than possibly in relation to any change to contribution limits).

First Home Saver Accounts– make available as (temporary) Alternative under Superannuation Choice of Fund

Housing Affordability

Housing affordability has become an increasingly important issue for Australian Governments.

Much of this “affordability crisis” is a result of unsustainable cyclical price increases (fuelled by capital gains tax discounts). This will ultimately be resolved through price corrections (whereby property prices fall relative to wages - as has occurred on previous occasions).

There is one factor that is not a cyclical factor which impacts on young people’s ability to purchase a first home. Young people (unlike previous generations) have reduced capacity to save for a house as a result of forced saving for retirement.

Impact of Housing on Retirement Planning

That home ownership is considered desirable is well argued by others. However one aspect that is often not considered is the impact that home ownership has on retirement planning and retirement savings. In particular:

- As part of overall assets at retirement, the home is much more financially significant superannuation. Approximate values based on average superannuation available for those currently retiring, and the median house price and median pre retirement salary are:

Item	Value at retirement (for a couple)
Super	2.5 times pre retirement income [4]
House	6 to 8 times pre retirement income[5]

- The home often plays an important part in retirement planning - “downsizing” the home (selling a large home, purchasing a small home, releasing equity to assist funding retirement needs).

- Home ownership reduces future Age Pension outlays (no rent assistance or public housing required).

- Reverse Mortgages allow home owners to access the equity in the home and use it to meet retirement needs.

[4] Based on an average earnings of $61,000 pa (ABS 6302 Full time adult total earnings) plus part time earnings of say $20,000 and average superannuation balance for a couple at retirement $200,000 authors estimate based on ASFA Retirement Saving Update (Feb 2008)
[5] Based on median house price (ABS 6416.0 June quarter 2008)

RECOMMENDATION: First Home Saver Accounts as Choice of Fund

The difficulty faced by the current generation of workers in purchasing a home has been recognised by the Government which has established the legislative infrastructure for First Home Saver Accounts.

One idea to further encourage the use of this initiative is to allow First Home Saver Accounts (FHSA) to be a valid <u>alternative</u> under Superannuation Choice of Fund.

Once the FHSA has been closed (to release funds for the purchase of the first home, or transfer to superannuation), superannuation contributions for retirement would be resumed.

Some observations can be made:

- Overcomes previous objections of using superannuation for housing:
    - It does not breach the sole purpose test
    - It does it doesn't decrease accumulated national superannuation savings.
    - It won't represent a once off large stimulus to the property sector which might cause another housing bubble (as FHSA's have restrictions on access during first 4 years).

Tax treatment of Superannuation and FSHA's is similar (and could readily be harmonised).

Issues

It is appreciated that the following issues need to be addressed:

- Possible harmonisation of Superannuation Guarantee and FHSA contribution limits;

- Taxing of employer contributions in FHSA;

- Possibly allowing split of contributions between super fund and FHSA

General Comments on Taxation of Individuals

The Terms of Reference of the Inquiry include consideration of areas of taxation where simplification can be achieved.

One of the logical approaches to this task is to examine the possibility of elimination of some existing taxes. The Tax Review background document draws attention to many taxes which raise little revenue.

We note also that Payroll Tax is arguably an impediment to employment, and that the ad valorem Stamp Duty on house sales represents a significant burden for purchasers. Certainly, the latter acts as a brake on the natural meeting of needs of buyers and sellers.

The corollary of the elimination of specific taxes is the increase of other taxes.

The Review specifically excludes the Goods and Services Tax. However, we consider that it is essential that our submission makes suitable mention of it in order to meet the Review's request for ideas on simplification.

A broad based expenditure tax has three important virtues. Being broad based, a low rate can raise significant revenue. In not taxing savings, it encourages these to community economic advantage.

It is also a reliable source of government revenue – which stamp duty on property transactions is not.

Arguably, if sufficiently broad, a single percentage expenditure tax is the fairest of all taxes – effectively raising tax in proportion to each individual's personal expenditure.

Some have argued that, as poorer people tend to spend a greater proportion of their income than higher earners, the tax is "regressive". Even if this argument is accepted, the welfare system can provide a more than suitable offset. In Australia, child support, unemployment and disablement benefits and the Age Pension are all level payments and means tested. Basic medical services through Medicare are provided out of a progressive personal income tax.

The federal and state governments should seriously consider:

(a) broadening the base of the GST, and

(b) increasing the rate of the GST,

as measures to raise revenue to:

(1) offset the elimination of other taxes, and

(2) increase the states' access to a reliable source of revenue.